COMMENT REGARDING COMPETITIVE BIDDING PROCEDURES FOR AUCTION No. 68

DA 06-997

AU Docket No. 06-101

Before the Federal Communications Commission
445 12th Street SW
Washington, DC 20554

In a Public Notice dated August 24, 2006, the FCC seeks comments regarding competitive bidding procedures for Auction No. 68. In section II.B.7 of the aforementioned Public Notice, it is proposed that bidders in Auction No. 68 not be permitted to withdraw bids placed in any round after the round has closed. Although the FCC acknowledges that bid withdrawals facilitate an efficient aggregation of licenses and construction permits, it is alleged that this rationale may not be compelling due to the limited number and wide geographic dispersion of permits available in Auction No. 68. However, this reasoning is seriously flawed.

A. If withdrawals are not permitted, it will be difficult or impossible for Auction 68 bidders to aggregate permits by entering into mutually beneficial exchanges with existing licensees and permit holders. In order to achieve a desired aggregation, winning bids may be required for a combination of two or more geographically dispersed permits.

Even though the Auction 68 permits are geographically dispersed, auction participants may wish to exchange one or more of these permits with other broadcast licensees who are not participating in the auction. The goal of such an exchange is to achieve a desired geographically-based aggregation based not only on the new permits being offered in Auction 68, but also based upon a vast portfolio of existing permits and licenses. In order to achieve a desired aggregation, an Auction 68 bidder may be required to successfully bid on a combination of two or more permits, even though such permits do not appear to be geographically related. If withdrawals are not permitted, it will be difficult or impossible for bidders to aggregate permits by entering into mutually beneficial exchanges with existing licensees and permit holders. Auction revenue will decrease as some participants refrain from bidding, while others bid very cautiously. Many potential participants will quickly lose interest in an auction that does not provide a withdrawal option, deeming the possible benefit of winning a permit not worth the substantial risk of making an irreversible mistake.

A hypothetical example using the Auction 68 allotments of Ocracoke, NC and Tecopa, CA will be presented for explanatory purposes. Indeed, these allotments appear to be geographically dispersed. However, assume that BBB Broadcasting holds an extensive portfolio of licenses and construction permits, including an outstanding CP for Fayetteville, NC, but does not intend to participate in Auction 68. EEE Broadcasting, wishing to acquire a cluster of stations in NC, reaches an agreement with BBB. EEE will participate in Auction 68. If EEE wins both Ocracoke and Tecopa, then BBB agrees to exchange its Fayetteville CP for EEE's Tecopa CP, thereby providing EEE with its desired geographically-based cluster. Although the permits themselves are geographically dispersed, the permits are, in fact, geographically related by means of the BBB-EEE agreement. If EEE fails to win both permits at auction, EEE cannot achieve its desired aggregation of permits. Assuming that bid withdrawals are banned, auction participants such as EEE do not wish to incur the substantial risk of winning only one of two desired permits.

B. In addition to aggregation, other legitimate reasons exist for exercising bid withdrawals. The bid withdrawal option encourages aggressive bidding, thereby enhancing auction revenue.

In section II.B.7 of the above-captioned Public Notice, it is stated that "in some instances bidders may seek to withdraw bids for improper reasons." However, existing FCC rules and regulations fail to provide explicit guidelines by which bidders are able to determine whether or not a given withdrawal has been tendered for a proper reason. Implicitly, it appears that bid withdrawals are proper in situations where bidders are attempting to aggregate permits (as described above). At the other end of the spectrum, it appears that bid withdrawals are improper in situations where a bidder consistently outbids several competitors until these competitors lose all eligibility, whereupon the bidder then withdraws a high standing bid. One might suggest that a bid withdrawal is improper if the underlying bid is placed in bad faith to keep a competitor from obtaining an allotment, or to obtain information about a competitor's bidding strategy, with the bidder having no intention of winning the permit.

In addition to aggregation, there are other legitimate reasons for exercising bid withdrawals. Although the FCC has attempted to encourage auction participation on the part of small businesses, certain auction rules work to the detriment of these small businesses. The ability to withdraw a standing high bid ameliorates the severity of these rules, thereby encouraging aggressive bidding and enhancing auction efficiency. To be specific, the activity requirement makes it extremely difficult for small businesses to focus on a desired permit while totally refraining from bidding on unwanted permits. If a well-behaved bidder confines their bidding solely to the desired permit, the activity requirement mandates placement of yet another bid every time they are displaced as the standing high bidder. An expensive bidding war ensues, with the small businessperson being shut out of the auction in short order.

In order for a bidder to maintain eligibility while keeping price increases on a desired permit to a tolerable level, auction rules implicitly encourage bidding on permits having little value to the bidder. This phenomenon, known as "parking", has been discussed at length in a textbook entitled, "Auctioning the Radio Spectrum", Chapter 1 of Auction Theory for Privitization, by P. Milgrom, Cambridge University Press, 1998. In the case of a small businessperson, bidding on one or more undesired permits will prevent the cost of a desired permit from escalating beyond reach. As the auction progresses, the small businessperson may be outbid on the undesired license, whereupon he will commence bidding on the desired license. If such outbidding does not occur, the bidder may exercise a withdrawal to shift gears from the undesired license to the desired license. Under these circumstances, the withdrawal option provides a means of escape for the small businessperson who is effectively using the withdrawal to exchange an undesired permit for a desired permit. Use of a withdrawal in this manner is appropriate, permissible, and completely distinguishable from situations where a bidder engages in gaming to uncover critical information concerning a competitor's business strategy.

Small businesses are concerned about the cost of a desired permit escalating beyond reach because the current bidding credit scheme fails to provide a level playing field for all players. A majority of participants in Auctions 37 and 62 qualified for a full (35%) or partial (25%) discount, notwithstanding the fact that many of these qualifying entities had access to deep financial reserves.

If bid withdrawals are banned, many small businesspeople will be discouraged from participating in Auction 68. Those who do participate will be guarded and cautious in their bidding for fear of getting stuck with an undesired allotment. Lack of a withdrawal option will have a chilling effect on bidding, dramatically reducing auction participation and revenue.

C. Auction 68 should be opened to all qualified bidders.

One or two commenters may suggest that bidders who previously withdrew bids in Auctions 37 and/or 62 be banned from participating in Auction 68. In advocating such a position, these commenters hope to acquire the Auction 68 allotments at greatly reduced prices while forcing former bidders to pay extreme withdrawal penalties without recourse.

Proposing to ban bid withdrawals in Auction 68 suggests that the bid withdrawal procedures previously employed in Auctions 37 and 62 were flawed, resulting in bid withdrawals that are now considered problematic. If the FCC believes that some or all of the withdrawn bids in Auctions 37 and 62 were improper, the FCC should provide bidders with the opportunity to reinstate formerly withdrawn bids on all unsold permits. Specifically, in the interests of efficiency, the FCC should offer each of the Auction 68 allotments to the bidder having the highest standing withdrawn bid. If a bidder elects to purchase the allotment at the price of their previously withdrawn bid (with any applicable bidding credit applied as of the date of the withdrawn bid), the allotment would be removed from Auction 68 and sold to the respective bidder, possibly sparing the administrative expense of another auction.

D. If the auction withdrawal provisions employed in Auctions 37 and 62 are modified for Auction 68, the withdrawal payment provisions should also be modified.

Pursuant to existing FCC rules and regulations, withdrawal payments are based on the concept of restitution. Specifically, if a subsequent winning bid is less than the amount of a withdrawn bid, the withdrawing bidder must pay the difference between their withdrawn bid and the subsequent winning bid. From a legal standpoint, restitution-based remedies calculate damages based upon fair market value. However, fair market value is not necessarily equivalent to the amount of a party's withdrawn bid. In some situations, the FCC is extracting a withdrawal payment "bonus" from bidders far in excess of the fair market value of a permit. Such a payment is tantamount to a government windfall. Moreover, excessive withdrawal payments discourage future auction participation by small businesses fearing financial ruin.

The FCC should not be allowed to extract a withdrawal payment that represents a penalty beyond current fair market value. Since the full withdrawal payment is not assessed at the time of the withdrawal, no calculation of fair market value should be assessed until the allotment is sold at a subsequent auction. Fair market value should be assessed at the time the payment is charged.

Under the United States Constitution, procedural due process may mandate a hearing to determine fair market value prior to assessing a withdrawal payment against a bidder. This is especially important if the bidder is a small business or sole proprietorship where the bidder faces financial ruin or bankruptcy at the hands of a withdrawal payment equivalent to five or ten years of hard-earned income, and far in excess of the fair market value of the permit in question. In determining fair market value, one must consider recent interest rate increases which, in turn, reduce the price one is willing to pay for a permit. Likewise, if a permit serves an area that has experienced a recent decrease or increase in population, this will also determine the price one is willing to pay. Disregarding the practical realities of a free market economy is completely unrealistic.

Respectfully submitted this 6th day of September 2006

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